

# HOW LONG WILL PERPETUAL LEASES LAST IN OHIO OIL AND GAS LAW?

*Chris Tassone\**

## I. INTRODUCTION

Imagine that you are a farmer on a 100-acre farm in eastern Ohio. One day in 2006, a representative from an oil drilling company, referred to as a landman, comes to your door and offers you a bonus payment of \$100 per acre for the rights to the oil and gas underneath your land.<sup>1</sup> The company will also pay you for one sixth (1/6) of the value of the oil and gas that your land produces as a royalty payment.<sup>2</sup> The terms of the lease state that it will last ten years and “so long thereafter as the well is being produced in paying quantities.” Additionally, if the company fails to drill a well in a given year, then it will pay you a rental payment of \$5 per acre for each year that your land remained unused.

This sounds like a great deal to you. The initial bonus payment to you is \$10,000 and you seem to be guaranteed at least \$500 per year even if the company does not drill. Over the course of a ten-year lease, that is \$15,000 minimum income. This is a new concept for how to use your land. Previously you had believed that only the surface land had value, for farming purposes. You had never thought about its valuable mineral rights. You take the landman’s deal; you sign the lease and collect the \$10,000 bonus check.

A few years later, in 2009, you are out in town and run into your old friend, Ed, from the other side of the county. You tell him about your lease deal, and how much money you received from it. The drilling company has not even drilled yet and you just continue collecting your \$500 rental checks each year. Your neighbor is shocked to hear about how much money you made. Ed has the same size of farm (100 acres), and he just sold his mineral rights for \$500,000. Now your \$10,000 bonus payment seems like pocket change. And it is pocket change when compared to the value of unsold mineral rights in your county. Now you want to get your piece of property back on the market.

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<sup>1</sup> JOHN S. LOWE, OIL AND GAS LAW IN A NUTSHELL 442 (5th ed. 2009) (defining bonus payment as “a payment to induce a lessor to execute the lease”).

<sup>2</sup> *Id.* at 509 (defining royalty interest as “[a] share of production or the value, or the proceeds of production, free of the costs of production, when and if there is production. . . . A royalty-interest owner has no right to operate the property, and therefore has no right to lease or to share in bonus or delay rentals”).

You think about it, and at least you only signed a ten-year lease. In only six more years, you might be able to resell it. But wait, in the fine print of your contract was the clause that extends your lease indefinitely (“so long thereafter as oil is being produced in paying quantities”). You agreed to this term, but it still seems wrong to you. You seem locked into this lease for perpetuity, being vastly underpaid, while your neighbors are making their fortunes. Now, you want to find a way to break this lease and renegotiate under different terms.

This is a fictitious scenario about the farmer and Ed. There are, however, some factual similarities to the realities faced by landowners in Ohio since 2006 when Ohio became a hot spot for a new drilling technology called hydraulic fracturing. Ohio is rich in oil and gas, and below its surface lays two major shale formations: the Marcellus and the Utica. The dollar amounts in the farmer’s story accurately portray the increase in value for the mineral rights under certain acreage in Ohio.<sup>3</sup> Under these economic conditions in 2011, a group of landowners, all of whom leased their mineral rights to Beck Energy Corporation subject to a standard form lease agreement, filed suit to invalidate their agreements.<sup>4</sup> The Monroe County Court of Common Pleas sided with the landowners in their attempts to quiet title to their land.<sup>5</sup> This decision has caused a great deal of uncertainty amongst oil and gas drilling companies and it brought up a discussion of Ohio’s public policy to develop land that has been dormant for nearly a century.

This Note will address the issue of perpetual leases in mineral rights contracts in the State of Ohio. Section II will provide background on hydraulic fracturing and its impact on Ohio landowners. Section III will address the evolution of the “no-term” or “perpetual” lease in mineral rights agreements. This will include an analysis of how different oil producing states have interpreted the primary and secondary terms as they operate in the habendum clause.<sup>6</sup> Section IV will analyze the case

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<sup>3</sup> Blake A. Watson, *Ohio Oil and Gas Litigation in the New Fracking Era*, OHIO ST. L.J., FURTHERMORE, 47, 55 (2013) available at <http://moritzlaw.osu.edu/students/groups/oslj/files/2013/05/Furthermore.Watson.pdf> (citing the original complaint in *Cameron v. Hess Corp.*, No. 2:12-cv-00168, 2012 WL 6086478 (S.D. Ohio Feb. 23, 2012). The plaintiffs allege, “as a direct and proximate result of the superior knowledge Mason Dixon withheld from all class members, it was able to unconscionably lease class members’ oil and gas rights for between \$5.00 and \$500.00 per acres when the true value of said rights to class members was between \$5,000.00 and \$6,000.00 per acre, and where the value of such leases among oil and gas companies is between \$10,000.00 and \$20,000.00 per acre.”).

<sup>4</sup> See generally *Hupp v. Beck Energy Corp.*, No. 2011-345, 2012 WL 7160375 (Ohio Ct. Com. Pl. July 12, 2012) (Trial Order).

<sup>5</sup> *Id.*

<sup>6</sup> BLACK’S LAW DICTIONARY (4<sup>TH</sup> pocketed ed. 2011) (defining habendum clause as “provision of an oil-and-gas lease defining how long the interest granted to the lessee will extend. Modern oil-and-gas leases typically provide for a primary term

of *Hupp v. Beck Energy Corporation*, in which the Ohio Court of Appeals for the Seventh District overturned a Monroe County decision and upheld the enforcement of a standard form oil and gas lease called Form G & T 83.<sup>7</sup> The standard form agreement was originally invalidated by the Monroe County Court of Common Pleas in a class action lawsuit involving more than 200 landowners because it was deemed to be against public policy.<sup>8</sup> Section V will propose an Ohio solution to issue of the perpetual that will need to be decided in *Hupp v. Beck Energy* as it is brought before the Ohio Supreme Court in 2015.<sup>9</sup>

## II. HYDRAULIC FRACTURING IN OHIO

Hydraulic fracturing,<sup>10</sup> otherwise known as “fracing” or “fracking” is not new to the State of Ohio.<sup>11</sup> Vertical hydraulic fracturing has occurred in Ohio since 1949.<sup>12</sup> However, since 2006, the introduction of horizontal drilling has fostered an increase in hydraulic fracturing activity in the State of Ohio.<sup>13</sup> Horizontal drilling requires much more capital expenditure than vertical drilling, yet the return on investment is much greater than traditional vertical drilling.<sup>14</sup>

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– a fixed number of years during which the lessee has no obligation to develop the premises - and a secondary term (for ‘so long thereafter as oil and gas produced’) once development takes place.”)

<sup>7</sup> *Hupp v. Beck Energy Corp.*, 2014-Ohio-4255, ¶ 10, 20 N.E.3d 732, 737 (Ohio Ct. App. September 26, 2014).

<sup>8</sup> See generally *Hupp v. Beck Energy Corp.*, 2012 WL 7160375 (Ohio Ct. Com. Pl.).

<sup>9</sup> *Hupp v. Beck Energy Corp.*, 141 Ohio St.3d 1454, 2015-Ohio 4255, 23 N.E.3d 1196, *appeal allowed*, (Discretionary appeal accepted on Proposition of Law Nos. I and II; sua sponte, cause consolidated with 2014-0423, *State ex rel. Claugus Family Farm, L.P. v. Seventh Dist. Court of Appeals*).

<sup>10</sup> Geological Society of America, *GSA Critical Issue: Hydraulic Fracturing*, HYDRAULIC FRACTURING DEFINED, ([insert access date]) <http://www.geosociety.org/criticalissues/hydraulicFracturing/defined.asp> (“Hydraulic fracturing...is a technique used to stimulate production of oil and gas after a well has been drilled. It consists of injecting a mixture of water, sand, and chemical additives through a well drilled into an oil- or gas-bearing rock formation under high but controlled pressure.”)

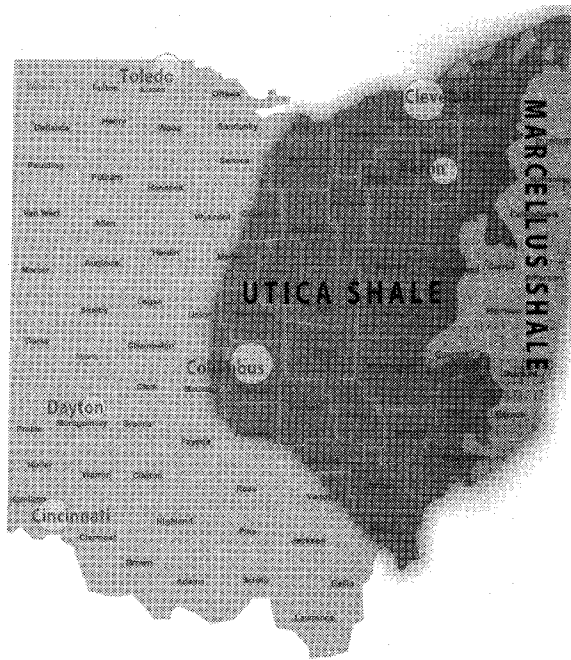
<sup>11</sup> Geological Society of America, *GSA Critical Issue: Hydraulic Fracturing*, HYDRAULIC FRACTURING DEFINED, (April 17, 2015) <http://www.geosociety.org/criticalissues/hydraulicFracturing/defined.asp> (“Hydraulic fracturing...is a technique used to stimulate production of oil and gas after a well has been drilled. It consists of injecting a mixture of water, sand, and chemical additives through a well drilled into an oil- or gas-bearing rock formation under high but controlled pressure.”)

<sup>12</sup> THE OHIO ENVIRONMENTAL COUNCIL, *SHALE GAS DEVELOPMENT IN OHIO 2* (2013) *available at*

<http://www.theoec.org/sites/default/files/FrackingResourceDoc2013web.pdf>

<sup>13</sup> *Id.*

<sup>14</sup> See BLAKE A. WATSON, *FRACKING – FACTS AND FEARS 5* (2012), *available at* [https://www.udayton.edu/directory/law/documents/watson/fracking\\_facts\\_fears\\_04](https://www.udayton.edu/directory/law/documents/watson/fracking_facts_fears_04)



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Horizontal drilling has allowed for oil and gas companies to capture the vast amount of shale gas embedded in the Marcellus Shale and Utica Shale underlying the Eastern half of Ohio (see map above).<sup>16</sup> The Marcellus Shale covers a larger area than any other shale play in the United States.<sup>17</sup> The Marcellus Shale underlies parts of West Virginia, Ohio, New York, Maryland, and Pennsylvania, containing 262 trillion cubic feet of natural gas.<sup>18</sup> Experts believe that 50 trillion cubic feet of that gas can be extracted, which is enough to fulfill the United States' natural gas demand for two full years.<sup>19</sup> Ohio's Utica Shale also has vast energy reserves.<sup>20</sup> In addition to natural gas, fracking in the Utica Shale is producing crude oil and liquefied natural gas.<sup>21</sup>

Drilling in the Utica and Marcellus Shales has made a significant

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092012.pdf (explaining that the costs of drilling a horizontal well range from \$2 - \$10 million a well (citing Sheila Nolan Gartland, *Crude Awakening: Anticipated Oil and Gas Production in Ohio*, OHIO LAWYER, Nov.-Dec. 2011, available at <https://www.ohiobar.org/NewsAndPublications/News/OSBANews/Pages/OSBANews-1799.aspx>)

<sup>15</sup> See THE OHIO ENVIRONMENTAL COUNCIL, *supra* note 11, at 2.

<sup>16</sup> WATSON, *supra* note 13, at 5.

<sup>17</sup> U.S. ENERGY INFORMATION ADMINISTRATION, REVIEW OF EMERGING RESOURCES: U.S. SHALE GAS AND SHALE OIL PLAYS (2011) available at <http://www.eia.gov/analysis/studies/usshalegas/pdf/usshaleplays.pdf>

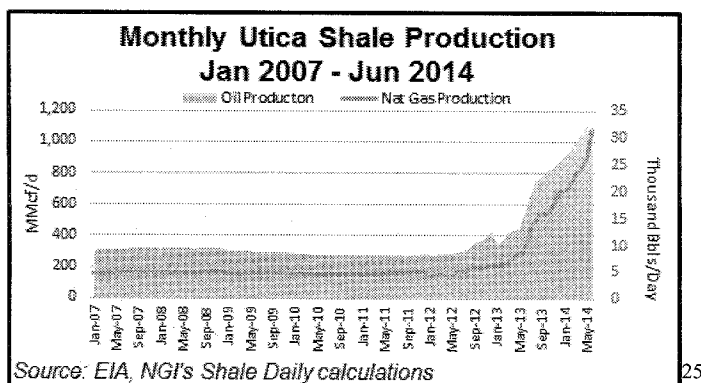
<sup>18</sup> WATSON, *supra* note 13, at 5.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

impact on the State of Ohio's economy. Based on a 2011 study, in 2010, the oil and gas industry generated approximately \$988 million in gross state product for Ohio.<sup>22</sup> The same study estimated that drilling companies and operators distributed \$90 million to Ohio landowners in royalty payments and generated \$32.7 million in Federal, state, and local tax revenue.<sup>23</sup> Additionally, in the last year (2014) there has been more development of the Utica Shale than ever before. The Natural Gas Intel organization cited a recent Energy Information Administration study to describe this increase in development: "According to EIA (official energy statistics from the U.S. government) data, combined liquids and natural gas production from the Utica grew from just 207 MMcf/d (millions of cubic feet equivalent per day) in January 2007 to 1.5 Bcfe/d (billions of cubic feet equivalent per day) in December 2014..."<sup>24</sup> As production of the Utica Shale increases, it is likely that drilling companies will continue to invest in Ohio property and seek new mineral rights.



Ohio law allows owners of real property to separate their real property interest from their mineral rights.<sup>26</sup> Landowners may, therefore, remain surface owners while leasing the land's mineral interest to another party.<sup>27</sup> These lease agreements typically contain two payment

<sup>22</sup> OHIO OIL AND GAS ENERGY EDUCATION PROGRAM, OHIO NATURAL GAS AND CRUDE OIL ECONOMIC IMPACT STUDY (2011), *available at* <http://c.ymcdn.com/sites/www.ooga.org/resource/resmgr/Docs/Economic-Impact-Study-Result.pdf>.

<sup>23</sup> *Id.*

<sup>24</sup> Natural Gas Intel, *Information of the Utica Shale*, NGI'S SHALE DAILY (August 30, 2015), <http://www.naturalgasintel.com/uticainfo>.

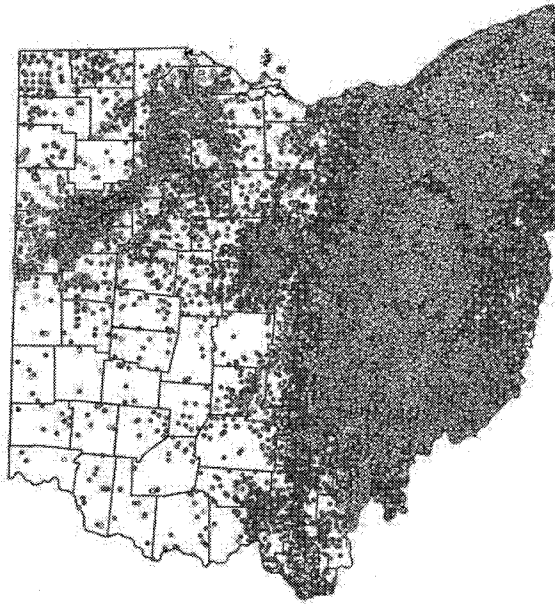
<sup>25</sup> *Id.*

<sup>26</sup> OHIO STATE UNIVERSITY EXTENSION AGRICULTURAL & RESOURCE LAW PROGRAM, *FACING THE POSSIBILITY OF LEASING FOR SHALE GAS DEVELOPMENT ON YOUR LAND*, (2014) *available at* <http://aglaw.osu.edu/sites/aglaw/files/site-library/Facing%20Possibility%20of%20Leasing.pdf>.

<sup>27</sup> *Id.*

provisions: an up-front bonus payment and a royalty payment for the landowner's share of a well's income.<sup>28</sup>

The new access to oil and gas caused by horizontal fracturing has led to a surge in the acquisition of mineral rights by prospective drillers.<sup>29</sup> Concurrent with demand, the cost of leasing mineral rights has soared.<sup>30</sup> In 2006, when general interest in the Marcellus Shale just began, signing bonuses averaged around \$100 per acre.<sup>31</sup> In 2008, these speculative wells proved to be very productive and the area signing bonuses climbed to over \$2,000 per acre.<sup>32</sup> In 2012, the price of a mineral rights signing bonus for Marcellus Shale acreage sold for as high as \$5,200 per acre.<sup>33</sup> Certain studies have valued Ohio High Quality land to be \$8,200 per acre.<sup>34</sup>



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<sup>28</sup> *Id.*

<sup>29</sup> Ben Westbrook, *Hupp v. Beck Energy Corp.: The Future of Oil and Natural Gas Development in Ohio*, 6 KY. J. EQUINE, AGRIC. & NAT. RESOURCES L. 277, 279-80 (2014)

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> See Watson, *supra* note 3.

<sup>34</sup> FARMERS NATIONAL COMPANY AGENT SURVEY, OHIO HIGH QUALITY LAND, June 2013 available at <http://www.alberscommunications.com/fnc/6-2013/BW-OHIO.pdf>.

<sup>35</sup> See OHIO OIL AND GAS ENERGY EDUCATION PROGRAM, *supra* note 19 (This graphic represents the oil and gas wells that have been drilled in the State of Ohio. "[T]here have been more than 275,000 wells drilled in Ohio. Today, more than 64,000 wells producing natural gas and crude oil in Ohio.").

The dramatic rise in oil and gas lease prices is likely to be a primary factor for many landowners who have sought to invalidate the oil and gas leases that they had previously signed. One such landowner's perspective is demonstrated in a complaint filed by landowners in Columbiana County alleging fraud and civil conspiracy to invalidate their leases:

From 2008 through 2010, few Columbiana County landowners understood the significance of the Utica shale play. . . . [M]any landowners enter[ed] into oil and gas leases in which they received less than 1% of the fair market value for the up-front Signing Bonus payments that are currently being paid in Columbiana County and without requiring appropriate lease provisions that would protect the landowners and their lands against the much greater risks and disruptions which accompany horizontal drilling.<sup>36</sup>

Landowners, as plaintiffs, have frequently sought legal action to invalidate, terminate, and interpret their leases.<sup>37</sup> A class of 200 lessors sought declaratory judgment to invalidate their leases in *Hupp v. Beck Energy Corporation*.<sup>38</sup>

#### *A. The Habendum Clause*

Oil and gas drilling is inherently speculative and expensive.<sup>39</sup> For these reasons, the lessee who is an oil and gas producer will regularly insert a habendum clause to achieve its two main goals: (1) to have the option to drill on land that they lease, but not the obligation to do so,<sup>40</sup> and (2) to enter into agreements that enable the producer to extend the time period of the lease if the property is producing a profitable amount of resources.<sup>41</sup> In order to accomplish these two goals, oil and gas producers originally created “no-term leases,” which allowed for lessees to extend the length of the lease so long as they paid a rental payment to the lessor.<sup>42</sup> These “delay rental payments” are made to the landowner as a sort of penalty for not drilling a well and a substitution for royalty

<sup>36</sup> *Koonce v. Chesapeake Exploration, L.L.C.*, No. 12-CV-00736, at ¶¶ 8-9 (N.D. Ohio Mar. 27, 2012) (citing the original complaint in *Koonce v. Chesapeake Exploration, L.L.C.*, No. 2012-CV-136 (C.P., Columbiana Cnty., Ohio, Mar. 27, 2012)).

<sup>37</sup> *Watson*, *supra* note 3.

<sup>38</sup> *Hupp v. Beck Energy Corporation*, No. 2011-345, 2012 WL 7160375 (Ohio Ct. Com. Pl. July 12, 2012).

<sup>39</sup> *See WATSON*, *supra* note 13.

<sup>40</sup> *See Westbrook*, *supra* note 19.

<sup>41</sup> *See LOWE*, *supra* note 1, at 169.

<sup>42</sup> *Westbrook*, at 281 (citing John S. Lowe et al., *Cases and Materials on Oil and Gas Law* 337 (5th ed. 2008)).

payments.<sup>43</sup> Over time, courts came to invalidate these leases for violating a public policy to promote development of land: they did not set a deadline for development.<sup>44</sup>

In order to avoid the effect of a perpetual primary term to leases, oil and gas producers created delay rental provisions that limit payment of delay rentals for only as long as the primary term of the lease.<sup>45</sup> Thus, if a lessee never drills a well that produces oil and gas "in paying quantities" at the end of the primary term, then the lessee's right to the minerals terminates.<sup>46</sup> The following provision is a common formulation: "This lease shall be for a term of [X] years from this date, called 'primary term' and as long thereafter as oil and gas are produced."<sup>47</sup> This provision was intended to balance the state's public policy interest in developing the land, but also allowing oil and gas producers to delay drilling until they can reasonably predict a well's profitability.

### *1. The Primary Term and Delay Rental Payments*

The primary term of the habendum clause should be considered an option period for the lessee.<sup>48</sup> The lessee has the option to drill and invest in the land during the primary period.<sup>49</sup> If the lessee does not choose to drill and invest, then he will forfeit his right to renew the lease under the secondary term.<sup>50</sup> The length of the primary term is negotiable between lessor and lessee, and the amount of the bonus payment will depend on the length of time in the primary term.<sup>51</sup> Lessors typically prefer to shorten the primary term because of their economic interest in drilling as well; lessors will only receive royalty interest payments upon production of a well.<sup>52</sup>

The most common type of delay rental clause provides that the lease will automatically terminate "unless" the lessee drills a well or

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<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> See LOWE, *supra* note 1, at 192.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 461–62. Royalty interest is defined as "a share of production, or the value or proceeds of production, free of the costs of production, when and if there is production. Royalty is usually expressed as a fraction; e.g., 1/6. A royalty-interest owner has no right to operate the property, and therefore no right to lease or to lease or share in bonus or delay rentals."



pays delay rentals.<sup>53</sup> The lease will cut short if delay rental payments are not made promptly.<sup>54</sup> These delay rental payments can be paid in any time frame (yearly/monthly/quarterly) depending on the terms to which the two parties agree.<sup>55</sup>

Another issue under this primary term is the definition of “drilling operations.” Does commencement of drilling a well satisfy the requirement or does a well need to be in production? Generally most courts hold that mere commencement of the well will satisfy the requirement.<sup>56</sup> This standard presents a low threshold for lessees in some states. A Louisiana court held that a lease was preserved when a lessee merely built an access road to the site, and did not bring any of the drilling equipment to the site.<sup>57</sup> This liberal standard is widespread: other courts have ruled that any clear action by the lessee of an *intent* to develop the land will be enough, so long as the lessee pursues development.<sup>58</sup>

## 2. *The Secondary Term and “Paying Quantities”*

Ohio law has confirmed that the secondary term of a habendum clause can be triggered when there is production of oil and gas in “paying quantities,” or operations are being conducted to search for oil and gas.<sup>59</sup> Under Ohio law it is critical that the lessee actually begin to produce oil and gas; mere speculation is not sufficient.<sup>60</sup> The term ‘paying quantities,’ when used in the habendum clause of an oil and gas lease, has been construed by the weight of authority to mean quantities of oil or gas sufficient to yield a profit, even small, to the lessee over

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<sup>53</sup> *Id.* at 205–206. The other, less common, type of delay rental provision will have an “or” clause. These clauses impose an affirmative duty on the lessee to pay a delay rental.

<sup>54</sup> *Id.* at 209.

<sup>55</sup> *Id.* at 203.

<sup>56</sup> *Id.* at 211.

<sup>57</sup> *Id.* (citing *Breaux v. Apache Oil Corporation*, 240 So.2d 589 (La.App.1970)).

<sup>58</sup> *Id.*

<sup>59</sup> § 47:8. Express terms of oil or gas lease—Habendum clause—Secondary term, Baldwin’s Oh. Prac. Real Est. § 47:8; Curtis v. American Energy Development, Inc., 2002-Ohio-3122, 2002 WL 1357726, \*3 (Ohio Ct. App. 11<sup>th</sup> Dist. Lake County 2002) (discussing a lease in which “the language clearly states that the lease will terminate if the second well is not commenced within eighteen months of the execution of the lease”).

<sup>60</sup> *Murdock-West Co. v. Logan*, 69 Ohio St. 514, 519-20 (1904) (holding that “while the parties interested may have entertained a well-founded opinion as to the outcome of the well, oil in paying quantities had not yet been found, obtained, or produced. In order to continue their lease beyond the stipulated time, it was necessary for the lessees to find oil in paying quantities.”); *Hanna v. Shorts*, 125 N.E. 2d 338, 340 (1955).

operating expenses, even though the drilling costs, or equipping costs, are not recovered, and even though the undertaking as a whole may thus result in a loss.<sup>61</sup>

In *Blausey*, the Sixth District Court of Appeals stated that "the term 'operating costs'... include[s] the royalties paid, administrative expenses of overhead, labor and repairs, and taxes."<sup>62</sup> Despite these statements that oil and gas wells must be profitable, Ohio courts grant considerable discretion to the lessee in determining what is a "paying quantity."<sup>63</sup> In *Blausey*, the Ohio Supreme Court affirmed the Sixth District Court of Appeals' reasoning in that, "the prevailing rule seems to be that [the] phrase 'paying quantities' to be construed from the standpoint of the lessee, and by his judgment if exercised in good faith."<sup>64</sup> The Ohio Supreme Court further held in *Blausey* that "the lessee should be allowed to attempt to recoup his initial investment for as long as he continues to derive any financial benefit from production."<sup>65</sup> This good faith standard is still limited by the Ohio Supreme Court's holding in *Murdock-West Co.*, in which the Court invalidated a lease because speculation of a well's production could not extend the lease past its initial term.<sup>66</sup>

Since the *Murdock-West Co.* decision in 1904, different appellate courts have eased the "paying quantities" requirement for lessees.<sup>67</sup> One Ohio appellate court held that a lessee could renew his oil and gas lease so long as he can show that the well will create a profit in the future, despite past failure to produce in paying quantities.<sup>68</sup> Nevertheless, the lessee cannot arbitrarily hold the lease.<sup>69</sup> Thus, under the current State of Ohio law, a well is considered to be producing in paying quantities so long as the well is capable of producing in paying quantities in the good-faith judgment of the lessee.

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<sup>61</sup> *Blausey v. Stein*, 400 N.E. 408, at 410 (Ohio 1980).

<sup>62</sup> *Id.*

<sup>63</sup> *See Id.*

<sup>64</sup> *Id.*; Baldwin's Oh. Prac. Real Est. § 47:8.

<sup>65</sup> *Blausey*, 400 N.E. 2d at 410.

<sup>66</sup> *See supra* note 49.

<sup>67</sup> *See supra* note 61; *See Litton v. Geisler*, 80 Ohio App. 491, 495-95, 36 Ohio Op. 289, 76 N.E.2d 741 (4th Dist. Lawrence County 1945): [T]he fact it is questionable whether oil wells on land held under a lease operate only so long as oil or gas should be found in paying quantities will ever yield a reasonable profit on the investment is not sufficient ground for vacating the lease; in the absence of fraud, the lessee is the sole judge of this question, and as long as he can make a profit therefrom he will be permitted to do so. The mere fact that a lessee under such a lease has failed to operate the wells for some time, will not be ground for vacating such lease, where such lessee shows good and sufficient reason why it has been impracticable for him to do so.

<sup>68</sup> *See Litton, supra* note 68, at 741.

<sup>69</sup> Baldwin's Oh. Prac. Real Est. § 47:8.

Other oil producing states have handled this same issue of determining “paying quantities” in different ways. Recently, the Pennsylvania Supreme Court in *T.W. Phillips Gas and Oil Co. v. Jedlicka*, addressed the issue of the habendum clause and established a subjective good faith standard for determining paying quantities.<sup>70</sup> The Plaintiff was seeking to quiet title on his land because the mineral rights lease suffered a loss in production in 1959.<sup>71</sup> Jedlicka argued that the mineral rights interest automatically reverts to the grantor upon the occurrence of an event – here, the loss of production.<sup>72</sup> The Pennsylvania Supreme Court, nonetheless, held for a subjective test in determining paying quantities, instead of the rigid objective test advocated by the Plaintiff.<sup>73</sup> The Court held that the determination of paying quantities “must be based on the unique circumstances of each individual case, and be driven by consideration of the good faith judgment of the operator.”<sup>74</sup>

The *Jedlicka* decision places a difficult burden on the lessor to prove that the lessee is acting in bad faith.<sup>75</sup> The Pennsylvania Supreme Court stated that whether or not a well is producing in paying quantities is based solely on the judgment of the lessee, “unless it can be established that he is not acting in good faith on his business judgment, but instead is acting with fraudulent or dishonest intent.”<sup>76</sup> Effectively, the landowner must prove that the lessee’s interest in the land is purely speculative despite potential evidence that the lessee is operating the wells at a loss.<sup>77</sup>

This new pure subjective good faith standard as established by *Jedlicka* is at odds with standards established in other oil producing states, like Texas and Oklahoma.<sup>78</sup> In *Gypsy Oil Co. v. Marsh*, the Oklahoma Supreme Court recognized that a lessee’s good faith judgment of paying quantities is only relevant if it is not objectively proven that the well is not producing in paying quantities.<sup>79</sup> The Supreme Court of Oklahoma calculated the revenues and expenses to find that Gypsy Oil Co. was operating at a loss, and therefore could *not* be acting in good faith.<sup>80</sup>

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<sup>70</sup> *T.W. Phillips Gas and Oil Co. v. Jedlicka*, 615 Pa. 199, 42 A. 3d 261 (2012).

<sup>71</sup> *Id.* at 264.

<sup>72</sup> *Id.* at 267.

<sup>73</sup> *Id.* at 275.

<sup>74</sup> *Id.*

<sup>75</sup> Joseph R. Plukas, *Energy Law-Not Balancing Well Interests Well: How the Supreme Court of Pennsylvania Mismanaged Oil and Gas Lease Policy in T.W. Phillips Gas & Oil Co. v. Jedlicka*, 36 W. New Eng. L. Rev. 68, 69 (2014).

<sup>76</sup> *Supra* note 57, at 275.

<sup>77</sup> Plukas, *supra* note 61, at 99.

<sup>78</sup> *Id.* at 70.

<sup>79</sup> *Gypsy Oil Co. v. Marsh*, 248 P. 329, 334 (1926).

<sup>80</sup> *Id.* at 330–31; Plukas, *supra* note 61, at 80.

In later years, Oklahoma has removed itself from the strict economic test in *Gypsy Oil*.<sup>81</sup> Oklahoma added more factors to its determination of paying quantities: "[T]he lease continues in existence so long as interruption of production in paying quantities does not extend for a period longer than reasonable or justifiable in light of all the circumstances involved. But under no circumstances will cessation of production in paying quantities Ipso facto deprive the lessee of his extended-term estate."<sup>82</sup> Thus, the result of this ruling is that the determination depends on the circumstances surrounding cessation.<sup>83</sup>

The Supreme Court of Texas affirmed the *Marsh* standard in *Garcia v. King*.<sup>84</sup> The court held for the lessor and added several arguments in favor of an objective understanding of "paying quantities."<sup>85</sup> First, if there is a substantial difference between the profit and operating expenses of a well, then there is no reason to grant authority to the good faith judgment of the lessee.<sup>86</sup> Second, oil and gas lease disputes should always be interpreted to the "mutual benefit of" both parties.<sup>87</sup> Thirdly, the lessors should not be bound to the continuation of a lease based on the mere speculation of the lessee.<sup>88</sup>

The Supreme Court of Texas modified this paying quantities standard in *Clifton v. Koontz* by introducing a two-part test.<sup>89</sup> First, there is an objective analysis of whether or not it is producing in paying quantities, in that revenues exceed expenses.<sup>90</sup> Secondly, if the well is not currently making a profit, then the lessee is subject to the reasonably prudent operator standard.<sup>91</sup> This is a determination of whether or not under all the relevant circumstances a reasonably prudent operator, for the purpose of making a profit and not merely for speculation, would continue to operate the well.<sup>92</sup> This determination can be made with the assistance of expert testimony.<sup>93</sup>

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<sup>81</sup> See *supra* note 1 at 203. This pure economic standard is also known as "the legal test." "[I]f the economic analysis of the litmus test leads a court to the conclusion that a lease is no longer profitable, the lease terminates without further analysis." *Id.*

<sup>82</sup> *Stewart v. Amerada Hess Corporation*, 604 P.2d, 854, 858 (1979).

<sup>83</sup> *Id.*; Mohan Kelkar, *The Effect of the Cessation of Production Clause During the Secondary Term of an Oil and Gas Lease*, *Tulsa Law Journal*, 532, 537 (1987) (highlighting the ambiguity in the term cessation. Courts have struggled with the interpretation of this term. Kelkar argues that the term is correctly interpreted to mean 'permanent cessation' and not just a temporary period of non-production).

<sup>84</sup> *Garcia v. King*, 164 S.W. 2d. 509, 512 (Tex. 1942).

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 513.

<sup>89</sup> *Clifton v. Koontz*, 325 S.W.2d. 684 (Tex. 1959).

<sup>90</sup> *Id.* at 692.

<sup>91</sup> *Id.* at 691.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

## IV. HUPP V. BECK ENERGY CORPORATION

The enforceability and validity of the habendum clause came under scrutiny by Ohio courts in *Hupp v. Beck Energy Corporation*. In September 2014, the Ohio Court of Appeals for the Seventh District reversed a 2012 Monroe County Court of Common Pleas holding that would have invalidated over 200 leases.<sup>94</sup> Plaintiffs filed claims against Beck Energy Corporation, seeking declaratory judgment to invalidate their respective leases and quiet title to their land.<sup>95</sup> All of the plaintiffs to the case were landowners in Monroe County.<sup>96</sup> Each had signed the Beck Energy standard form lease, Form G & T 83.<sup>97</sup>

In their argument, the plaintiffs challenged that Paragraphs 2 and 3 of the Form G & T 83 lease operated as a perpetual lease with no obligation on the lessee to develop the land, and should therefore be void as against public policy.<sup>98</sup> The relevant provisions are as follows:

**Paragraph 2.** This lease shall continue in force and the rights granted hereunder be quietly enjoyed by the Lessee for a term of ten years and so much longer thereafter as oil and gas or their constituents are produced or are capable of being produced on the premises in paying quantities, in the judgment of the Lessee, or as the premises shall be operated by the Lessee in the search for oil or gas and as provided in Paragraph 7.

**Paragraph 3.** This lease, however, shall become null and void and all rights of either party hereunder shall cease and terminate *unless*, within 12 months from the date hereof, a well shall be commenced on the premises, or *unless* the Lessee shall thereafter pay a delay rental of \_\_\_\_ each year, payments to be made quarterly until the commencement of a well. A well shall be deemed commenced when preparations for drilling have commenced.

**Paragraph 19.** ...no implied covenant, agreement or obligation shall be read into this agreement or imposed upon the parties...<sup>99</sup>

All of the named plaintiffs owned property subject to the Form G&T 83

<sup>94</sup> *Hupp supra* note 9; *Hupp supra* note 7, at \*1.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 2.

<sup>97</sup> *Id.*

<sup>98</sup> *Hupp supra* note 9.

<sup>99</sup> *Id.*

lease, but their delay rental payment prices differed.<sup>100</sup> For example, Larry and Lori Hutsack entered an agreement with Beck in August 2008 to lease the mineral rights to their 89.75-acre property.<sup>101</sup> This lease specified a delay rental payment of \$108.00.<sup>102</sup> Another landowner David Majors contracted with Beck to lease the mineral rights to his 55 acres. His lease set a delay rental payment of \$55.00.<sup>103</sup>

#### *A. Monroe County's Analysis: Lease Creates a Perpetual Interest*

Monroe County's analysis focused on the important public policy in developing the land under the lease and the perpetual nature of Paragraphs 2 and 3. Monroe County granted summary judgment to the plaintiffs "because the leases in question clearly, unequivocally and seriously offend public policy in that they are perpetual leases that, by their terms and the payment of a nominal delayed rental may never have to be put into production."<sup>104</sup> The court further held that Beck Energy had breached its implied covenant to reasonably develop the land by not drilling any wells.<sup>105</sup> Thus, Monroe County held that the leases were void ab initio and authorized the forfeiture of the lease.<sup>106</sup>

Throughout its opinion, Monroe County set out several public policy considerations that are compromised by a perpetual lease. The court recognized that contracts are to be unenforceable when it permits "that which has a tendency to be injurious to the public or against the public good."<sup>107</sup> Further, the court recognized that it is the public policy of the state to encourage oil and gas production when it can be done without undue harm to the safety and welfare of Ohio citizens.<sup>108</sup> The court also recognized that there is an implied covenant to develop a leasehold for mineral production.<sup>109</sup> If a leasehold is not developed within a reasonable amount of time, then there is a public interest in termination of the lease to make possible for alienation and other use of

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<sup>100</sup> *Id.*

<sup>101</sup> *Hupp supra* note 8.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*; BLACK'S LAW DICTIONARY 346 (4<sup>th</sup> pocket ed. 2011) defines void ab initio as "Null from the beginning, as from the first moment when a contract is entered into. A contract is void ab initio if it seriously offends law or public policy, in contrast to a contract that is merely voidable at the election of one party to the contract."

<sup>107</sup> *Hupp supra* note 8.

<sup>108</sup> *Id.* (citing *Newbury Township Board of Trustees v. Lomak Petroleum (Ohio), Inc.*, 62 Ohio St.3d 387, 389, 583 N.E. 302 (Ohio)).

<sup>109</sup> *Id.* (citing *Jacobs v. CNG Transmission Corp.*, 332 F.Supp. 2d 759, 786 (W.D. Pa. 2004)).

the land.<sup>110</sup>

Monroe County's application of an implied covenant to develop stems from the Ohio Supreme Court's holding in *Ionno v. Glen-Gery Corp.*<sup>111</sup> In *Ionno*, a coal lease did not have a time limit for when mining was to begin.<sup>112</sup> The lease allowed for delay rental payments.<sup>113</sup> Nonetheless, the Ohio Supreme Court invalidated the lease because the lessee breached its implied obligation to develop the land.<sup>114</sup> The Court separated the obligations in the contract from the implied obligation of the lease: "An annual advance payment which is credited against future royalties cannot be viewed as a substitute for timely development. To hold otherwise would be to reward mere speculation without development, effort, or expenditure on the part of the lessees."<sup>115</sup> The Court reasoned that such a lease would encumber the property in perpetuity and is therefore against public policy.<sup>116</sup>

The Monroe County Court interpreted Paragraph 3 of the Form G & T 83 lease to allow the lessee (Beck Energy) to make delay rental payments for perpetuity and forego drilling forever. Monroe County reasoned that "[b]y paying delay rentals, this land could potentially never be developed by the Defendant's payment of a very minimal payment to the plaintiffs."<sup>117</sup> Beck Energy argued that this language should be construed to limit the number of years available for delay rental payments at ten, the original number of years of the lease as set out in Paragraph 2.<sup>118</sup> The Court rejected Beck Energy's interpretation.

Further, Monroe County interpreted Paragraph 2 to allow ownership of the land in perpetuity because the lease allows for the Defendant (lessor) to determine what constitutes "paying quantities."<sup>119</sup> Under this interpretation, therefore, the lessee could easily extend the lease forever because of the ambiguous meaning of a "paying quantity."

Thus, the Court invalidated the leases for all members of the class action suit because the language of Paragraphs 2 and 3 effectively allowed the leases to be held in perpetuity. Ohio has an interest in promoting the development its land to produce oil and gas.<sup>120</sup> The provisions of Form G & T 83, as interpreted by Monroe County, impose no explicit obligation to develop the land. Under Ohio law, however, oil and gas leases should construe an implied covenant to reasonably

<sup>110</sup> *Jacobs v. CNG Transmission Corp.*, 332 F.Supp.2d 759 at 779 (W.D. Pa. 2004).

<sup>111</sup> *Ionno v. Glen-Gery Corp.*, 2 Ohio St.3d 131 (1983).

<sup>112</sup> *Id.* at 131.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 134.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Hupp v. Beck Energy Corp.*, 2012 WL 7160375, at \*8 (Ohio Ct. Com. Pl.).

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at \*9.

<sup>120</sup> *Newbury Township*, 523 N.E. 2d at 308.

develop the land.<sup>121</sup> Since Beck Energy failed to drill any wells on the acreage in question, Beck breached its implied covenant to develop.

*B. Seventh District's Analysis: No Perpetual Interest Was Created*

The Court of Appeals of Ohio for the Seventh District *reversed* the Monroe Court of Appeals and *validated* all of the Form G & T 83 leases. The Seventh District found Monroe County's reasoning to be flawed for four main reasons: (1) Form G & T 83 is not a no-term (perpetual) lease because it contains a primary and a secondary term; (2) the delay rental provision in Paragraph 3 only applies to the primary terms of the lease; (3) the phrase "capable of production" in Paragraph 3 refers to whether the well, *not the land*, is capable of production; and (4) the determination of "paying quantities" is not subject to the sole discretion of the lessee.<sup>122</sup> This sub-section of the note will briefly discuss each of these points of reasoning and address future concerns.

First, the Form G & T 83 lease is not a no-term (perpetual) lease. The lease has separate primary and secondary terms.<sup>123</sup> Although the Seventh District did not cite any Ohio Supreme Court cases, the court found authority in other Ohio Appellate and Seventh District cases to substantiate its conclusion.<sup>124</sup> The habendum clause is two tiered. The primary term is a definite duration (ten years). The secondary term has an indefinite duration and will extend the lessee's rights so long as the condition of the lease is met. This condition will be met so long "as oil and gas or their constituents are produced or capable of being produced on the premises in paying quantities..."<sup>125</sup>

Second, the Seventh District recognized that it is a matter of settled law that delay rental provisions only apply to the primary term of the lease.<sup>126</sup> The court recognized that, historically, delay rental provisions were inserted into mineral rights leases so to avoid the effect (and invalidation) of a no-term lease. The Seventh District found it contradictory to create a habendum clause that must terminate within a certain amount of time, and, in the next clause, destroy that provision by letting the lessee delay production of the lease forever by the payment of

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<sup>121</sup> *Ionno*, 443 N.E. 2d at 506–07.

<sup>122</sup> *Hupp v. Beck Energy Corporation*, 2014-Ohio-4255, ¶¶ 86–115.

<sup>123</sup> *Id.* ¶ 86.

<sup>124</sup> See, e.g., *Am. Energy Serv. v. Lekan*, 598 N.E.2d 1315 (Ohio Ct. App. 1992); *Gardner v. Oxford Oil Co.*, 2013-Ohio-5885, 7 N.E.3d 510; *Swallie v. Rousenberg*, 2010-Ohio-4573, 190 Ohio App.3d 473, 942 N.E. 2d 1109.

<sup>125</sup> *Hupp v. Beck Energy*, 2014-Ohio-4255, at ¶ 9.

<sup>126</sup> *Northwestern Ohio Natural Gas Co. v. City of Tiffin*, 54 N.E. 77 (1899) (concluding that a lease with a delay rental payment provision "expires at the end of the specified term, unless within that time oil and gas is obtain from the land in the designated quantities."); *Brown v. Fowler*, 63 N.E. 76 (1902).



a delay rental.<sup>127</sup>

Third, the term “capable of production” in the secondary terms of the habendum clause signifies that the *well* is capable of producing, and not only that the *land* is capable of producing. This interpretation limits the ability of lessees to extend the lease.<sup>128</sup> Thus, this interpretation requires a well to be drilled and begin producing during the first term in order to trigger the secondary term.<sup>129</sup>

Fourth, the lease should not be invalidated just because the lessee has discretion in determining what constitutes a “paying quantity” from the well.<sup>130</sup> The Seventh District affirmed that the phrase “paying quantities” requires the judgment of the lessee to determine if oil and gas is capable of being produced in paying quantities. Nonetheless, the Seventh District identified the common purpose of continuing to use a well in the secondary term, noting that, “it would be contrary to the joint economic interest of both a landowner and the lessee to continue drilling if it was no longer financially feasible.”<sup>131</sup> Additionally, the Seventh District stated that the lessor’s determination of “paying quantities” has never been a reason to invalidate a lease in the past, so it did not do so here. And even though the Seventh District did not impose this standard in *Hupp*, the court recognized how many other courts impose a good faith standard on the lessee’s determination of paying quantities.<sup>132</sup>

Further, the Seventh District court held that there is no implied covenant to develop the land when there is an express provision to the contrary. The Seventh District distinguished *Ionno v. Glen-Gery Corp.* from *Hupp*. In *Ionno*, the Supreme Court of Ohio imposed an implied covenant to reasonably develop the land in a lease agreement that did not contain any specific reference to the timeliness of development. There was no disclaimer of an implied covenant in *Ionno*, whereas Form G & T 83 lease in *Hupp* has Paragraph 19: “...no implied covenant, agreement or obligation shall be read into this agreement or imposed upon the parties. . . .”<sup>133</sup> Thus, the Form G & T 83 lease disclaimed the implied covenant, and it therefore does not apply.

## V. PROPOSED SOLUTION

The *Hupp v. Beck Energy* case identifies several unsettled areas of

<sup>127</sup> See *Jacobs*, 332 F. Supp. 2d at 786, (citing WALTER LEE SUMMERS, A TREATISE ON THE LAW OF OIL AND GAS, (2nd ed. 1959).

<sup>128</sup> *Hupp v. Beck Energy*, 2014-Ohio-4255, at ¶ 101.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.* ¶ 102.

<sup>131</sup> *Id.*

<sup>132</sup> *T.W. Phillips Gas and Oil Co. v. Jedlicka*, 42 A.3d 261, 276 (Pa. 2012); *Weisant v. Follett*, 17 Ohio App. 371 (Ohio Ct. App. 1922).

<sup>133</sup> *Hupp v. Beck Energy Corp.*, 2012 WL 7160375, at \*5 (Ohio Ct. Com. Pl.).

Ohio law. The Seventh Circuit's decision has now been appealed to the Supreme Court of Ohio. Ohio will have the opportunity to clarify the enforceability of delay rental payments and determine what constitutes "paying quantities."<sup>134</sup> The interpretation of these provisions, as exemplified in Paragraphs 2 and 3 of the From G & T 83 lease in *Hupp*, will have the power to invalidate thousands of agreements between landowners and drilling companies. If these leases are to be invalid, then it will likely cause a slowdown in the production of minerals and the development of Ohio's emerging oil and gas economy.

Ohio has a clear public policy goal in promoting the production of oil and gas on its land so long as it is done safely.<sup>135</sup> This strong public policy caused the Monroe County Court of Common Pleas to invalidate the Form G & T 83 lease in *Hupp*.<sup>136</sup> Nevertheless, the Seventh District recognized that delay rental payments were enforceable under Ohio law so long as they were limited by the primary term of the lease.<sup>137</sup> The result of the Seventh District Court of Appeals is consistent with the established case law of the State of Ohio and the other oil producing states throughout the country. This perspective is bolstered by the Ohio Supreme Court's 1980 decision in *Blausey v. Stein*<sup>138</sup> and 1977 decision in *Myers v. East Ohio Gas Company* in which the court allowed for a very similar lease provision to be enforced.<sup>139</sup> Since *Blausey* and *Myers*, Ohio law has primarily been interpreted to validate these provisions. The delay rental provision does not create a perpetual lease, but rather an option contract extending only for the primary term of the lease.<sup>140</sup>

The Southern District of Ohio recently interpreted Ohio mineral rights law to always enforce leases based on their terms, even if the terms of such contract create a perpetual lease.<sup>141</sup> In analyzing a habendum clause, the court held "even if there is a perpetual lease here – and again, there is not – it would not invariably mandate proclaiming the lease void as against public policy. Although Ohio disfavors perpetual leases, it nonetheless permits them when that is what the parties intended."<sup>142</sup>

The understanding that the drilling company must either (i) drill a

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<sup>134</sup> Appellant's Memorandum in Support of Jurisdiction, *Hupp v. Beck Energy Corp.*, 20 N.E.3d (Ohio November 7, 2014).

<sup>135</sup> *Ionno*, 443 N.E.2d at 507.

<sup>136</sup> *Hupp v. Beck Energy Corp.*, 2012 WL 7160375, at \*29 (Ohio Ct. Com. Pl.).

<sup>137</sup> *Northwestern Ohio*, 54 N.E. 77.

<sup>138</sup> *Blausey*, at 409 ("The lease...provided that it would continue for a term of 'five years, or as long thereafter as oil or gas is found in paying quantities. . . .").

<sup>139</sup> *Myers v. East Ohio Gas Company*, 364 N.E.2d 1369 (1977).

<sup>140</sup> *Hupp v. Beck Energy*, 2014-Ohio-4255, at ¶ 92.(citing *Northwestern Ohio Natural Gas Co. v. City of Tiffin*, 54 N.E. 77 (1899)).

<sup>141</sup> *Phillips Exploration, Inc. v. Reitz*, 2012 WL 6594915 (S.D. Ohio 2012).

<sup>142</sup> *Id.* at \*6.

well or (ii) forfeit the mineral rights lease within the primary term of the lease still advances Ohio's public policy of developing the State's natural resources. Additionally, Seventh District's decision on the delay rental provision balances the interests of the drilling company by allowing the company to take its time, and secure its capital investment, before drilling a well. If the Ohio Supreme Court were to conclude that Ohio law does not permit delay rental payments as exemplified in the Form G & T 83 lease, then it would likely chill investment by oil and gas producers throughout the state. This result would, therefore, contradict Ohio's policy in promoting development of its natural resources.

There is, however, one remaining issue that is critical in determining the enforceability of Form G&T 83 and other similar agreements in Ohio: the interpretation of "paying quantities." Although different Courts of Appeals have established precedent, the Supreme Court of Ohio has not adjudicated the issue since it did so indirectly in *Blausey v. Stein*. The Supreme Court of Ohio should take the opportunity in *Hupp* to sharpen the rule in order to define the term under Ohio law.<sup>143</sup>

Landowners, such as the class of plaintiffs in *Hupp*, argue that, if the lessee can determine when a well is capable of producing in "paying quantities," then lessees can effectively encumber the land in perpetuity since a drilling company has little interest in granting the land back to the landowner.<sup>144</sup> The Seventh District nonetheless took the position that it would not be in the economic interest of the oil and gas producer to remain on the property, so courts should apply a good faith test to determine if the well is producing in paying quantities.<sup>145</sup> This rule is the precedent of the Seventh District in *Weisant v. Follett*.<sup>146</sup> In *Weisant*, this good faith judgment standard will not, however, allow for the lessee to retain the lease when there has been no production at all.<sup>147</sup>

The good faith judgment standard from *Weisant* and *Hupp* leaves a great amount of discretion to the lessee. Additionally, this good faith standard seems to contradict the standard set by the Supreme Court in *Blausey v. Stein*, in which the Court drew an economic determination of

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<sup>143</sup> *Blausey*, at 410.

<sup>144</sup> *Hupp v. Beck Energy Corporation*, 2012 WL 7160375 (Ohio Ct. Com. Pl.) (stating "...so much longer thereafter as oil and gas or their constituents are produced or are capable of being produced on the premises in paying quantities, in the judgment of the Lessee...").

<sup>145</sup> *Hupp v. Beck Energy*, 2014-Ohio-4255, at ¶ 92.

<sup>146</sup> *Id.* at ¶ 103 (citing *Weisant v. Follett*, 17 Ohio App. 371 (Ohio Ct. App. 1922) permitting the lessee to be "the sole judge on this question, and as long as he can make a profit therefrom, he will be permitted to do so"; and "left largely to his good judgment.").

<sup>147</sup> *Hanna v. Shorts*, 125 N.E.2d 338, 340 (1955).

“paying quantities.”<sup>148</sup> The precedent of *Blausey* seems to be at odds with the pure good faith standard, in that the *Blausey* standard requires some form of proven profit.<sup>149</sup> The *Blausey* standard is still ambiguous because it does not set a timeline for when a well needs to be profitable. What if a well operated at a drastic loss one year, but recovered the next year? Is it still profitable?

As Ohio approaches this issue of “paying quantities” in the new era of fracking, the State must be careful to consider the balance of interests between landowner and lessee. This pure good faith subjective determination set out in *Blausey* places great discretion in the hands of lessees to renew the leaseholds perhaps indefinitely. Under current Ohio law, so long as a leaseholder (i) confirms that the company has developed a well within the primary term of a leasehold and (ii) states that they have a good faith belief that the well will produce in paying quantities in the future (despite past losses), then they have the right to renew the lease. This standard places an uneven power of discretion in the lessees who have no interest in returning the land to the landowners when all that the leaseholder is required to pay is fractional royalty payments. Additionally, because it is very difficult to find evidence of bad faith in the production of oil and gas, it is more equitable to impose a reasonably prudent person standard on the production of paying quantities, as does the State of Texas.<sup>150</sup>

In respect to *Hupp v. Beck Energy Corp.*, the Seventh District was correct in holding that the habendum clause does not create a perpetual lease.<sup>151</sup> This result promotes equity amongst the parties who entered into the agreement under terms established by decades of oil and gas jurisprudence. It also promotes State’s interest in developing its natural resources, as there will be certainty in the enforceability of the two-part habendum clause. However, the habendum clause, as interpreted by many Ohio appellate courts, places too much power in the hands of the leaseholder to renew the lease indefinitely. Ohio law must define a rational economic standard for “paying quantities.” This new standard is best achieved by a pure economic test that will determine whether or not a well is profitable within a given year. Beyond the primary term, operating costs of the well may not exceed operating revenues. This information should be easy to obtain by the drilling company, as it is their economic interest to scrutinize the profitability of its wells. If Ohio allows for the reasonably prudent operator standard, then this places too high of a burden on landowners seeking to terminate their lease

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<sup>148</sup> *Blausey v. Stein*, 400 N.E.2d 408, 410 (1980).

<sup>149</sup> *See id.*

<sup>150</sup> *Clifton v. Koontz*, 325 S.W.2d. 684 (Tex. 1959).

<sup>151</sup> *Hupp v. Beck Energy Corp.*, 20 N.E.3d 732, 737 (Ohio Ct. App. September 26, 2014).

agreements and reclaim title to their land and mineral interests.<sup>152</sup>

## VI. CONCLUSION

Ohio is currently in a unique position to re-establish its oil and gas law. For many decades, oil and gas law was largely irrelevant because there was little drilling activity throughout the state. The modern technology of hydraulic fracturing has increased the value of much of Ohio's land because of the State's vast mineral reserves. Now, Ohio law must adapt to modern rules as it seeks to promote the development of the State's resources. The *Hupp v. Beck Energy Corporation* case presents important issues regarding lease agreements between landowners and drilling companies. In deciding *Hupp v. Beck Energy*, the Supreme Court of Ohio must balance the interests of the two parties. If drilling companies are not able to extend their leases beyond a set primary term, then it will chill development of oil and gas. At the same time, however, if the drilling companies are given too much discretion in determining what triggers extension of the lease in the secondary term, it places landowners at risk of abuse by drilling companies. Thus, the Ohio law should establish that habendum clauses *do not* create a perpetual interest in the property. Nonetheless, Ohio should limit the ability of a lessee to extend a secondary term of the lease by imposing a pure economic test to determine "paying quantities."

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<sup>152</sup> See *supra* note 132.

